



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79347; File No. SR-MSRB-2016-12)

November 17, 2016

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to MSRB Rules G-15 and G-30 to Require Disclosure of Mark-ups and Mark-Downs to Retail Customers on Certain Principal Transactions and to Provide Guidance on Prevailing Market Price

I. Introduction

On September 2, 2016, the Municipal Securities Rulemaking Board (“MSRB”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend MSRB Rule G-15 (“Rule G-15”), on confirmation, clearance, settlement and other uniform practice requirements with respect to retail customer (*i.e.*, non-institutional) transactions, and MSRB Rule G-30 (“Rule G-30”), on prices and commissions to require brokers, dealers and municipal securities dealers (collectively, “dealers”) to disclose mark-ups and mark-downs (collectively, “mark-ups” unless the context requires otherwise) to retail customers on certain principal transactions and to provide dealers guidance on prevailing market price (“PMP” or “prevailing market price”) for the purpose of calculating mark-ups and mark-downs and other Rule G-30 determinations (collectively, the “proposed rule change”). The proposed rule change was published for comment in the Federal Register on September 13, 2016.³ The Commission

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 78777 (Sep. 7, 2016), 81 FR 62947 (Sep. 13, 2016) (“Notice”).

received seven comment letters in response to the proposal.⁴ The Commission also received a letter from the Office of the Investor Advocate (“Investor Advocate”) recommending approval of the proposed rule change.⁵ On November 14, 2016, the MSRB responded to the comments⁶ and filed Amendment No. 1 to the proposal.⁷ The Commission is publishing this notice to solicit comment on Amendment No. 1 to the proposal from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposal, as Modified by Amendment No. 1

A. Background

The MSRB proposes to amend Rule G-15, on confirmation, clearance and other uniform practice requirements with respect to customer transactions, and Rule G-30, on prices and commissions to require dealers to disclose mark-ups and mark-downs to retail customers on certain principal transactions and to provide dealers guidance on prevailing market price for the

⁴ See Letter from Mike Nicholas, Chief Executive Officer, Bond Dealers of America (Oct. 4, 2016) (“BDA Letter”); Letter from Leslie M. Norwood, Managing Director and Associate General Counsel and Sean Davy, Managing Director, Capital Markets Division, Securities Industry and Financial Markets Association (Oct. 3, 2016) (“SIFMA Letter”); Letter from Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters (Sept. 19, 2016) (“Thomson Reuters Letter”); Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum (Oct. 4, 2016) (“FIF Letter”); Letter from Paige W. Pierce, President & CEO, RW Smith & Associates, LLC (Oct. 4, 2016) (“RW Smith Letter”); Letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC (Oct. 4, 2016) (“Wells Fargo Letter”); Letter from Norman L. Ashkenas, Chief Compliance Officer, Fidelity Brokerage Services, LLC, and Richard J. O’Brien, Chief Compliance Officer, National Financial Services, LLC, Fidelity Investments (Oct. 4, 2016) (“Fidelity Letter”).

⁵ See Letter from Rick A. Fleming, Investor Advocate, Office of the Investor Advocate, to Commission (Nov. 7, 2016) (“Investor Advocate Letter”).

⁶ See Letter from Michael L. Post, General Counsel–Regulatory Affairs, MSRB, to Secretary, Commission, dated November 14, 2016 (“MSRB Response”).

⁷ Amendment No. 1 is available on the Commission’s website at: <https://www.sec.gov/comments/sr-msrb-2016-12/msrb201612-11.pdf>.

purpose of calculating mark-ups and mark-downs and other Rule G-30 determinations.⁸ The MSRB also proposes to require for all transactions in municipal securities with retail customers, irrespective of whether mark-up/mark-down disclosure is required, that a dealer provide on the confirmation (1) a reference, and hyperlink if the confirmation is electronic, to a webpage hosted by the MSRB that contains publicly available trading data from the MSRB's Electronic Municipal Market Access ("EMMA") system for the specific security that was traded, in a format specified by the MSRB, along with a brief description of the type of information available on that page; and (2) the execution time of the customer transaction, expressed to the minute.⁹

The MSRB developed this proposal, as modified by Amendment No. 1, in coordination with the Financial Industry Regulatory Authority ("FINRA") to advance the goal of providing additional pricing information, including transaction cost information, to retail customers in corporate, agency, and municipal debt securities.¹⁰ The MSRB and FINRA have worked toward consistent rule requirements in this area, as appropriate, to minimize the operational burdens for dealers that are registered with the MSRB and FINRA members that transact in multiple types of fixed income securities.¹¹ The MSRB's proposal, as modified by Amendment No. 1, is before

⁸ See Notice, supra note 3. For ease of reference, a "non-institutional customer" is also alternatively referred to as a "retail customer" or "retail investor," which, among others is not included in the definition of an institutional customer.

⁹ See Amendment No. 1, supra note 7, at 4-5. See also Notice, supra note 3, at 16 n.29. The MSRB also proposes in Amendment No. 1. to add the term "offsetting" to proposed Rule G-15(a)(i)(F)(1)(b) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement, and extend the implementation period of the proposal from no later than one year to no later than 18 months.

¹⁰ See, e.g., Notice, supra note 3, at 62949, 62962.

¹¹ FINRA has filed with the Commission a proposal and amendment that is substantially similar to this proposal, as modified by Amendment No. 1. See Securities Exchange Act Release No. 78573 (Aug. 15, 2016), 81 FR 55500 (Aug. 19, 2016) (SR-FINRA-2016-032) ("FINRA Proposal"); see also FINRA Amendment No. 1, available at: <https://www.sec.gov/comments/sr-finra-2016-032/finra2016032-13.pdf>.

the Commission following a process in which the MSRB solicited comment on related proposals on three separate occasions and subsequently incorporated modifications designed to address commenters' concerns after each solicitation.¹²

1. Confirmation Disclosure of Pricing Information

In November, 2014, the MSRB, concurrently with FINRA, published a regulatory notice requesting comment on a proposal (the "Initial Proposal") to require disclosure of pricing information for certain same-day, retail-sized principal transactions.¹³ In the Initial Proposal, the MSRB proposed to require a dealer to disclose on the customer confirmation its trade price for a defined "reference transaction" as well as the difference in price between the reference transaction and the customer trade.¹⁴ The MSRB characterized a reference transaction generally as one in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same date as the customer trade.¹⁵ Under the Initial Proposal, the disclosure obligation would have been triggered only where the dealer was on the same side of the transaction as the customer (as purchaser or seller) and the size of such dealer transaction(s), in total, equaled or exceeded the size of the customer transaction.¹⁶ Designed to capture

¹² See MSRB Response, supra note 6, at 2.

¹³ See MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (Nov. 17, 2014), available at: <http://www.msrb.org/~media/files/regulatory-notices/rfcs/2014-20.ashx>. The Initial Proposal was published concurrently with a similar proposal by FINRA. See also FINRA Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets: FINRA Requests Comment on a Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions (Nov. 2014), available at: http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_14-52.pdf.

¹⁴ See Initial Proposal, supra note 13, at 8.

¹⁵ Id.

¹⁶ Id.

transactions with retail investors, the Initial Proposal's proposed disclosure obligation was limited to transactions of 100 bonds or less or bonds with a face value of \$100,000 or less.¹⁷

As more fully summarized in the Notice, the MSRB received a number of comments on the Initial Proposal.¹⁸ Some commenters supported the Initial Proposal, stating that the proposed confirmation disclosure would put investors in a better position to assess both whether they are paying fair prices and the quality of the services provided by their dealer, and also could assist investors in detecting improper practices.¹⁹ Some of these commenters urged the MSRB to expand the Initial Proposal so that it would apply to all trades involving retail investors.²⁰ But many commenters were critical of the Initial Proposal. Some commenters critical of the Initial Proposal believed that the proposed disclosure obligation would confuse retail investors, fail in its attempt to provide investors with useful information, be overly complex and costly for dealers to implement, and impair liquidity in the municipal securities market.²¹

In response to the comments received on the Initial Proposal, the MSRB made several modifications and solicited comment on a revised proposal (the "Revised Proposal").²² In the Revised Proposal, the MSRB proposed to depart from the "reference price" approach and instead require that dealers disclose the amount of mark-up/mark-down from the prevailing market price

¹⁷ Id. at 9-10.

¹⁸ See Notice, supra note 3, at 62958 (summarizing comments received by the MSRB on the Initial Proposal).

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² See MSRB Regulatory Notice 15-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (Sept. 24, 2015) ("Revised Proposal"), available at: <http://www.msrb.org/~media/files/regulatory-notice/rfcs/2015-16.ashx>.

for certain retail customer transactions.²³ Specifically, the MSRB proposed to require a dealer to disclose its mark-up/mark-down if the dealer bought (sold) the security in one or more transactions in an aggregate trade size that met or exceeded the size of the sale (purchase) to (from) the non-institutional customer within two hours of the customer transaction.²⁴ The disclosed mark-up/mark-down would be required to be expressed both as a total dollar amount and as a percentage of the PMP.²⁵ Additionally, the MSRB proposed to require the disclosure of two additional data points on all trade confirmations, even those for which mark-up/mark-down disclosure was not required: a security-specific hyperlink to the publicly available municipal security trade data on EMMA, and the time of execution of the customer's trade.²⁶

In response to similar comments received on its initial proposal, FINRA also made several modifications and solicited comment on a revised proposal.²⁷ These modifications, reflected in FINRA's revised proposal, were designed to ensure that the disclosure applied to transactions with retail investors, enhanced the utility of the disclosure, and reduced the operational complexity of providing the disclosure.²⁸

²³ Id. at 5-6.

²⁴ Id. at 7-8.

²⁵ Id. at 24.

²⁶ Id. at 7-8.

²⁷ FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets: FINRA Requests Comment on a Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions (Oct. 2015) ("FINRA Revised Proposal"), available at: http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf.

²⁸ See FINRA Proposal, supra note 11, at 55508 (explaining FINRA's modifications to its initial proposal in its revised proposal). FINRA's Revised Proposal included the following revisions: (i) replacing the "qualifying size" requirement with an exclusion for transactions with institutional accounts, as defined in FINRA Rule 4512(c); (ii) excluding transactions which are part of fixed-price offerings on the first trading day and which are sold at the fixed-price offering price; (iii) excluding firm-side transactions that are

Although the MSRB and FINRA took different approaches in their revised proposals – diverging primarily on the questions of whether to require disclosure of reference price or mark-up/mark-down, and whether to specify a same-day or two-hour time frame – each acknowledged the importance of achieving a consistent approach and invited comments on the relative merits and shortcomings of both approaches.²⁹ Following a second round of comments, publication of a third related proposal by the MSRB,³⁰ as well as investor testing conducted jointly by the MSRB and FINRA in mid-2016, the MSRB and FINRA made a third round of revisions to achieve a consistent approach and filed the proposed rule changes that are before the Commission.

conducted by a department or trading desk that is functionally separate from the retail-side trading desk; (iv) excluding trades where the member’s principal trade was executed with an affiliate of the member and the affiliate’s position that satisfied this trade was not acquired on the same trading day; (v) requiring members to provide a hyperlink to publicly available corporate and agency debt security trade data disseminated from TRACE on the customer confirmation; (vi) permitting members to omit the reference price in the event of a material change in the price of the security between the time of the member’s principal trade and the customer trade; and (vii) permitting members to use alternative methodologies to determine the reference price in complex trade scenarios, provided the methodologies were adequately documented, and consistently applied. See FINRA Revised Proposal, supra note 27.

²⁹ See Revised Proposal, supra note 22. In the Revised Proposal, consistent with FINRA, proposed that certain categories of transactions be excluded from the disclosure requirement, including (i) transactions with institutional accounts; (ii) firm-side transactions if conducted by a “functionally separate principal trading desk” that had no knowledge of the non-institutional customer transaction; and (iii) customer transactions at list offering prices. For trades with an affiliate of the firm, the MSRB also proposed to “look through” the firm’s trade with the affiliate to the affiliate’s trade with the third party for purposes of determining whether disclosure would be required. See id. at 9, 23.; see also FINRA Revised Proposal, supra note 27.

³⁰ See MSRB Regulatory Notice 2016-07, Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price (Feb. 18, 2016), (“PMP Proposal”), available at: <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2016-07.ashx>.

2. Prevailing Market Price Guidance

In February, 2016, the MSRB published the PMP Proposal soliciting comment on proposed amendments to Rule G-30 to incorporate therein supplemental material to provide guidance on establishing the prevailing market price and calculating mark-ups and mark-downs for principal transactions in municipal securities.³¹ In the PMP Proposal, the MSRB generally proposed that the prevailing market price of a municipal security be presumptively established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained.³² If this presumption is either inapplicable or successfully rebutted, the prevailing market price would generally be determined by referring in sequence to: (1) a hierarchy of pricing factors, including contemporaneous inter-dealer transaction prices, and, if the subject security is an actively traded security, contemporaneous inter-dealer quotations; (2) prices or yields of contemporaneous inter-dealer or institutional transactions in similar securities, and yields from validated contemporaneous quotations in similar securities; and (3) economic models.³³

As more fully summarized in the Notice, the MSRB received a number of comments on the PMP Proposal.³⁴ One commenter supported the PMP Proposal, stating that the proposed guidance was generally useful, clear, and consistent with the existing FINRA prevailing market price guidance, but also noted its concern that the PMP Proposal could permit a dealer to determine a misleading prevailing market price when a dealer sources a municipal security from

³¹ Id.

³² Id. at 4.

³³ Id. at 6-7.

³⁴ See Notice, supra note 3, at 62961-62.

an affiliated entity.³⁵ Other commenters were critical of the PMP Proposal. Some commenters argued that the hierarchical approach was inappropriate, that the guidance should incorporate more factors for dealers to consider, and that the guidance should have a more limited scope of applicability.³⁶ More generally, commenters suggested that the MSRB coordinate its efforts with respect to the PMP Proposal with FINRA to develop prevailing market price guidance that is consistent with FINRA's existing guidance in the supplementary material to FINRA Rule 2121.³⁷ In response to comments received, the MSRB modified or clarified several aspects of the PMP Proposal and filed the proposed rule change that is before the Commission.³⁸ The modifications and clarifications reflected in the Notice were designed to make the prevailing market price guidance generally less subjective and more easily susceptible to programming, and, at the same time, provide dealers with a greater degree of flexibility with respect to certain elements of the prevailing market price guidance, thus making the PMP Proposal's hierarchical approach more appropriate for the municipal securities market.³⁹

B. Proposed Amendments to Rule G-15 and Rule G-30

1. Mark-up/Mark-down Proposal

a. Overview

The MSRB proposes to amend Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to customer transactions. In particular, proposed Rule G-15(a) would require that a retail customer confirmation for a transaction in a

³⁵ Id. at 62961.

³⁶ Id. at 62961-62.

³⁷ Id. at 62962.

³⁸ Id.

³⁹ Id.

municipal security includes the dealer's mark-up/mark-down, to be calculated from the prevailing market price (as determined in compliance with the proposed amendments to Rule G-30) and expressed as a total dollar amount and as a percentage of the prevailing market price, if the dealer also executes one or more offsetting principal transaction(s) on the same trading day as the retail customer, on the same side of the market as the retail customer, in an aggregate size that meets or exceeds the size of the retail customer trade.⁴⁰ The MSRB also proposes to require for all transactions in municipal securities with retail customers, irrespective of whether mark-up disclosure is required, that the dealer provide on the confirmation (1) a reference, and if the confirmation is electronic, a hyperlink, to a webpage hosted by the MSRB that contains publicly available trading data from the MSRB's EMMA system for the specific security that was traded, in a format specified by the MSRB, along with a brief description of the type of information available on that page; and (2) the execution time of the customer transaction, expressed to the minute.⁴¹

Proposed Rule G-15(a) would specify limited exceptions to the mark-up disclosure obligation,⁴² and would address how a dealer's transaction with an affiliate is to be considered.⁴³

b. Scope

Under proposed Rule G-15(a), the mark-up disclosure requirement would, subject to certain exceptions, apply to transactions in municipal securities where the dealer buys (or sells) a municipal security on a principal basis from (or to) a retail customer and engages in one or more

⁴⁰ See Amendment No. 1, supra note 7, at 15.

⁴¹ Id. at 14. As the MSRB indicated in the MSRB Response, a dealer's existing obligation to disclose the time to trade execution to an institutional customer upon written request is not affected by the proposed rule change. See MSRB Response, supra note 6, at 5-6.

⁴² See Notice, supra note 3, at 62949-50.

⁴³ Id. at 62949.

offsetting principal trade(s) on the same trading day in the same security where the size of the dealer's offsetting principal trade(s), in aggregate, equals or exceeds the size of the retail customer trade.⁴⁴ A retail customer would be a customer with an account that is not an institutional account, as defined in Rule G-8(a)(xi) (i.e., a non-institutional account).⁴⁵ The proposed mark-up disclosure requirement would apply to transactions in municipal securities, other than municipal fund securities (as defined in MSRB Rule D-12).⁴⁶ The disclosure obligation would similarly not be required to be disclosed if the retail customer transaction is a list offering transaction (as defined in paragraph (d)(vii)(A) of Rule G-14 RTRS Procedures), or if a dealer's offsetting same-day principal transaction was executed by a trading desk that is functionally separate from the dealer's trading desk that executed the transaction with the retail customer.⁴⁷

Discussing the rationale for the mark-up disclosure requirement, the MSRB states that the proposed rule change would provide meaningful pricing information to retail investors, who would most benefit from such disclosure, while not imposing unduly burdensome disclosure requirements on dealers.⁴⁸ Furthermore, the MSRB states its belief that requiring disclosure for retail customers would be appropriate because such customers typically have less ready access to market and pricing information than institutional customers.⁴⁹

With respect to the same-trading-day timeframe of the proposed disclosure obligation, the MSRB states that it believes that the timeframe is appropriate because it will generally make a

⁴⁴ Id. at 62947.

⁴⁵ Id. at 62948 & n.14.

⁴⁶ Id. at 62950.

⁴⁷ Id. at 62949-50.

⁴⁸ Id. at 62948.

⁴⁹ Id. at 62948-49.

dealer's determination of the prevailing market price easier.⁵⁰ Additionally, the MSRB emphasizes that the same-trading-day timeframe, as opposed to the two-hour timeframe previously proposed, would produce the added benefits of ensuring that more investors receive the disclosure and reducing the likelihood that dealers would alter their trading behavior to avoid the proposed disclosure requirement.⁵¹

For purposes of determining whether the mark-up disclosure requirement is triggered, proposed Rule G-15(a) also addresses how dealer transactions with affiliates are to be considered. If a dealer executes an offsetting principal trade(s) with an affiliate, the rule would require the dealer to determine whether the transaction was an "arms-length transaction."⁵² The proposed rule defines an arms-length transaction as "a transaction that was conducted through a competitive process in which non-affiliate dealers could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the dealer."⁵³ If the transaction is not an arms-length transaction, the proposed rule would require the dealer to "look through" its transaction in a security with its affiliate to the affiliate's transaction(s) with a third-party in the security to determine whether the proposed mark-up disclosure requirement would apply.⁵⁴ The MSRB states that sourcing liquidity through a non-arms-length transaction with an affiliate is functionally equivalent to selling out of a dealer's inventory for purposes of the

⁵⁰ Id. at 62949.

⁵¹ Id. at 62949 & n.18.

⁵² Id. at 62949.

⁵³ See Amendment No. 1, supra note 7, at 16.

⁵⁴ See Notice, supra note 3, at 62949. The MSRB adds that, in a non-arm's length transaction with an affiliate, the dealer also would be required to "look through" to the affiliate's transaction with a third-party and related cost or proceeds by the affiliate as the basis for determining the dealer's calculation of the mark-up/mark-down pursuant to the proposed guidance. See id.

proposed disclosure requirement, and, therefore, it would be appropriate in those circumstances to require a dealer to “look through” to the affiliate’s transaction(s) with a third-party to determine whether the proposed disclosure requirement is triggered.⁵⁵

The proposed rule change also specifies three exceptions from the proposed disclosure requirement. First, if the offsetting same-day principal trade was executed by a trading desk that is functionally separate from the dealer’s trading desk that executed the transaction with the retail customer, the principal trade by the functionally separate trading desk would not trigger the mark-up disclosure requirement.⁵⁶ To avail itself of this exception, the dealer must have in place policies and procedures reasonably designed to ensure that the functionally separate trading desk through which the dealer purchase or sale was executed had no knowledge of the retail customer transaction.⁵⁷ According to the MSRB, this exception would allow an institutional desk within a dealer to service an institutional customer without triggering the disclosure requirement for an unrelated trade performed by a separate retail desk with the dealer.⁵⁸ The MSRB states that this exception is appropriate because it recognizes the operational cost and complexity that may result from using a dealer principal trade executed by a separate, unrelated trading desk as the basis for determining whether the mark-up disclosure requirement would be triggered.⁵⁹ Moreover, the MSRB notes its belief that requiring dealers to have policies and procedures in place that are reasonably designed to ensure that the separate trading desk had no knowledge of

⁵⁵ Id.

⁵⁶ Id. at 62949-50.

⁵⁷ Id. at 62950.

⁵⁸ Id. at 62949-50.

⁵⁹ Id. at 62949.

the retail customer transaction is a sufficiently rigorous safeguard to protect against potential abuse of this exception.⁶⁰

The second exception to the proposed mark-up disclosure requirement arises in the context of list-offering price transactions (as defined in paragraph (d)(vii)(A) of MSRB Rule G-14 RTRS Procedures).⁶¹ According to the MSRB, municipal securities purchased as part of a list-offering transaction are sold at the same published list offering price to all investors and the compensation paid to a dealer is paid by the issuer of the municipal securities and is typically described in the offering document for such securities.⁶² The MSRB notes, therefore, that the proposed mark-up disclosure would not be warranted for list-offering price transactions.⁶³

The third exception to the proposed mark-up disclosure requirement arises when a dealer transacts in municipal fund securities.⁶⁴ Specifically, the proposed mark-up disclosure requirement would not apply to transactions in municipal fund securities.⁶⁵ According to the MSRB, dealer compensation for municipal fund securities transactions is typically not in the form of a mark-up or mark-down and, therefore, the MSRB believes that the proposed mark-up disclosure requirement would not have application for transactions in municipal fund securities.⁶⁶

⁶⁰ Id. at 62950.

⁶¹ Id.

⁶² Id.

⁶³ Id.

⁶⁴ Id.

⁶⁵ Id.

⁶⁶ Id.

c. Information to be Disclosed and/or Provided

i. Mark-up/Mark-down

Proposed Rule G-15(a) would require the dealer's mark-up or mark-down to be calculated in compliance with Rule G-30 and supplementary material thereunder, including proposed Supplementary Material .06, and expressed as a total dollar amount and as a percentage of the prevailing market price.⁶⁷ The MSRB notes that disclosure of both the total dollar amount and the percentage of the PMP is supported by investor testing, which found the investors believed such disclosures would be useful.⁶⁸ According to the MSRB, it would be appropriate to require dealers to calculate the mark-up in compliance with Rule G-30, as new Supplementary Material .06 would provide extensive guidance on how to calculate the mark-up for transactions in municipal securities, including transactions for which disclosure would be required under the proposed rule change, and incorporates a presumption that prevailing market price is established by reference to contemporaneous cost or proceeds.⁶⁹ The MSRB recognizes that the determination of prevailing market price for a particular security may not be identical across dealers, but adds that dealers would be expected to have reasonable policies and procedures in place to determine prevailing market price in a manner consistent with Rule G-30, and that such policies and procedures would be applied consistently across customers.⁷⁰

In the Notice, the MSRB acknowledges that certain dealers provide trade confirmations on an intra-day basis, and states that nothing in the proposed rule change is meant to delay a

⁶⁷ Id.

⁶⁸ Id. at 62956.

⁶⁹ Id. at 62950.

⁷⁰ Id.

dealer's confirmation generation process.⁷¹ To that end, the MSRB states that a dealer may determine, as a final matter for disclosure purposes, the prevailing market price based on the information the dealer has, based on the use of reasonable diligence as required by proposed Rule G-30, at the time of the dealer's generation of the disclosure.⁷²

ii. Reference/Hyperlink to EMMA and Time of Trade

The proposed rule change, as modified by Amendment No. 1, would require a dealer to provide, in a format specified by the MSRB, a reference and, if the confirmation is electronic, a hyperlink to a webpage on EMMA that contains publicly available trading data for the specific security that was traded, along with a brief description of the type of information available on the page.⁷³ This disclosure requirement would be limited to transactions with retail customers, but would apply to all such transactions regardless of whether a mark-up disclosure is required for the transaction.⁷⁴ According to the MSRB, providing a security-specific URL on a trade confirmation would provide retail investors with a broad picture of the market for a security on a given day and would increase retail investor awareness of, and ability to access, this information.⁷⁵

The proposed rule change, as modified by Amendment No. 1, would also require a dealer to disclose the time of trade execution (expressed to the minute) on all retail customer trade confirmations, other than those for transactions in municipal fund securities.⁷⁶ According to the MSRB, dealers are currently obligated to either disclose the time of execution to their customers

⁷¹ Id.

⁷² Id.

⁷³ See Amendment No. 1, supra note 7, at 14.

⁷⁴ See Notice, supra note 3, at 62950-51.

⁷⁵ Id. at 62951.

⁷⁶ Id.; See Amendment No. 1, supra note 7, at 14.

or include a statement on trade confirmations that such information is available upon written request thereof, and the proposed rule change essentially deletes the option to provide this information upon request with respect to retail customers.⁷⁷ The MSRB believes that time of execution disclosure, together with the provision of a security-specific reference or hyperlink to EMMA on retail customer confirmations, would provide a retail customer a comprehensive view of the market for its security, including the market at the time of trade.⁷⁸ Moreover, the MSRB states that these disclosures would also reduce the risk that a customer may overly focus on dealer compensation at the expense of other factors relevant to the investment decision.⁷⁹

2. Prevailing Market Price Proposal

a. Overview

The MSRB proposes to add new supplementary material (paragraph .06 entitled – “Mark-up Policy”) and amend existing supplementary material under Rule G-30, on prices and commissions, to provide guidance on determining the prevailing market price and calculating mark-ups and mark-downs for principal transactions in municipal securities (the “proposed guidance”).⁸⁰ According to the MSRB, the proposed guidance would promote consistent compliance by dealers with their existing fair-pricing obligations under MSRB rules in a manner that would be generally harmonized with the approach taken in other fixed income markets, and would support effective compliance with the proposed amendments to Rule G-15(a).⁸¹ The

⁷⁷ See Notice, supra note 3, at 62951.

⁷⁸ Id.

⁷⁹ Id.

⁸⁰ Id.

⁸¹ Id.

proposed guidance sets forth a sequence of criteria and procedures that a dealer must consider when determining the prevailing market price for a municipal security.

In general, the proposed guidance provides that the prevailing market price of a municipal security be presumptively determined by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained; provided, however, if this presumption is either inapplicable or successfully rebutted, the dealer must, among other things, consider, in order (1) a hierarchy of pricing factors, including contemporaneous inter-dealer transaction prices, and, if the subject security is an actively traded security, contemporaneous inter-dealer quotations; (2) prices or yields from contemporaneous inter-dealer or institutional transactions in similar securities, and yields from validated contemporaneous quotations in similar securities; and (3) economic models.⁸² The MSRB states that the presumption in favor of contemporaneous costs incurred or proceeds obtained could be overcome in limited circumstances.⁸³ Moreover, the MSRB notes that the proposed guidance is substantially similar to and generally harmonized with FINRA's existing prevailing market price guidance in the supplementary material to FINRA Rule 2121.⁸⁴

b. Presumptive Use of Contemporaneous Cost

The proposed guidance provides that the best measure of prevailing market price is presumptively established by referring to the dealer's contemporaneous cost (proceeds).⁸⁵ Under the proposed guidance, a dealer's cost is (or proceeds are) considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be

⁸² Id. at 62952-54.

⁸³ Id. at 62952.

⁸⁴ Id.

⁸⁵ Id.

expected to reflect the current market price for the municipal security.⁸⁶ According to the MSRB, reference to a dealer's contemporaneous cost or proceeds in determining the prevailing market price reflects a recognition of the principle that the prices paid or received for a security by a dealer in actual transactions closely related in time are normally a highly reliable indicator of the prevailing market price and that the burden is appropriately on the dealer to establish the contrary.⁸⁷

In the Notice, the MSRB provides guidance to dealers for determining the prevailing market price for a municipal security when a dealer does not have contemporaneous cost or proceeds from an inter-dealer transaction, but instead has contemporaneous cost or proceeds from a retail customer transaction. According to the MSRB, when a dealer's contemporaneous cost or proceeds are derived from a retail customer transaction, the dealer should refer to such contemporaneous cost or proceeds and make an adjustment for any mark-up or mark-down charged in that customer transaction.⁸⁸ The MSRB notes that this approach is supported by relevant case law and is consistent with the text of the proposed guidance because under the proposed guidance the presumptive prevailing market price is, through this methodology, established "by referring to" the dealer's contemporaneous cost or proceeds.⁸⁹ Moreover, the MSRB notes that this approach is consistent with the fundamental principle underlying the proposed guidance because it results in a reasonable proxy for what the dealer's contemporaneous cost or proceeds would have been in an inter-dealer transaction.⁹⁰ Finally, the

⁸⁶ Id.

⁸⁷ Id.

⁸⁸ Id. at 62954.

⁸⁹ Id.

⁹⁰ Id.

MSRB states that because this adjustment occurs at the first level of the analysis, the prevailing market price so determined from this methodology by the dealer would be presumed to be the prevailing market price for any contemporaneous transactions with the same strength of the presumption that applies to prices from inter-dealer transactions.⁹¹

c. Criteria for Overcoming Presumption

The proposed guidance recognizes that a dealer may look to other evidence of the prevailing market price (other than contemporaneous cost or contemporaneous proceeds) only where the dealer, when selling (or buying) the security, made no contemporaneous purchases (sales) in the municipal security or can show that in the particular circumstances the dealer's contemporaneous cost (proceeds) is not indicative of the prevailing market price.⁹² In such circumstances, the dealer may be able to show that its contemporaneous cost (when it is making a sale to a customer) or proceeds (when it is making a purchase from a customer) are not indicative of the prevailing market price, and thus overcome the presumption, in instances where: (i) interest rates changed to a degree that such change would reasonably cause a change in the municipal security's pricing; (ii) the credit quality of the municipal security changed significantly; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the municipal security.⁹³

d. Pricing Alternatives to Contemporaneous Cost

Under the proposed guidance, if a dealer establishes that its cost is (or proceeds are) not contemporaneous or if the dealer has overcome the presumption that its contemporaneous cost (proceeds) provides the best measure of the prevailing market price, the dealer must consider, in

⁹¹ Id.

⁹² Id. at 62952.

⁹³ Id.

the order listed (subject to Supplementary Material .06(a)(viii), on isolated transactions and quotations), a hierarchy of three additional types of pricing information, referred to herein as the hierarchy of pricing factors: (i) prices of any contemporaneous inter-dealer transactions in the municipal security; (ii) prices of contemporaneous dealer purchases (or sales) in the municipal security from (or to) institutional accounts with which any dealer regularly effects transactions in the same municipal security; or (iii) if an actively traded security, contemporaneous bid (or offer) quotations for the municipal security made through an inter-dealer mechanism, through which transactions generally occur at displayed quotations.⁹⁴ The proposed guidance further provides that in reviewing the available pricing information for each level in the hierarchy of pricing factors, the relative weight of the information depends on the facts and circumstances of the comparison transaction or quotation.⁹⁵ The MSRB also states that because of the lack of active trading in many municipal securities, these factors may frequently not be available, and, as such, dealers may often need to consult factors further down the sequence of criteria, such as “similar” securities or economic models to identify sufficient relevant and probative pricing information to establish the prevailing market price of a municipal security.⁹⁶

e. Additional Alternatives to Contemporaneous Cost

If none of the three “hierarchy of pricing factors” is available, the proposed guidance provides that a dealer may take into consideration a non-exclusive list of factors that are generally analogous to those set forth under the hierarchy of pricing factors, but applied here to prices and yields of specifically defined “similar” securities.⁹⁷ Unlike the factors set forth in the

⁹⁴ Id.

⁹⁵ Id.

⁹⁶ Id. at 62952-53.

⁹⁷ Id. at 62953.

hierarchy of pricing factors, which must be considered in specified order, the factors related to similar securities are not required to be considered in any particular order or combination.⁹⁸ The non-exclusive factors are:

- Prices, or yields calculated from prices, of contemporaneous inter-dealer transactions in a specifically defined “similar” municipal security;
- Prices, or yields calculated from prices, of contemporaneous dealer purchase (sale) transactions in a “similar” municipal security with institutional accounts with which any dealer regularly effects transactions in the “similar” municipal security with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in “similar” municipal securities for customer mark-ups (mark-downs).⁹⁹

With respect to the similar security analysis, the MSRB states that the relative weight of the pricing information obtained through this analysis depends on the facts and circumstances surrounding the comparison transaction, such as whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction, the timeliness of the information, and, with respect to the final bulleted factor, the relative spread of the quotations in the similar municipal security to the quotations in the subject security.¹⁰⁰

The proposed guidance provides that a “similar” municipal security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment for the

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Id.

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Id.

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Id.

investor.¹⁰¹ At a minimum, the municipal security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the “similar” security or securities.¹⁰² The proposed guidance also sets forth a set of non-exclusive factors that a dealer may use in determining the degree to which a security is “similar.”¹⁰³ These include: (i) credit quality considerations; (ii) the extent to which the spread at which the “similar” municipal security trades is comparable to the spread at which the subject security trades; (iii) general structural characteristics and provisions of the issue; (iv) technical factors such as the size of the issue, the float or recent turnover of the issue, and legal restrictions on transferability as compared to the subject security; and (v) the extent to which the federal and/or state tax treatment of the “similar” municipal security is comparable to such tax treatment of the subject security.¹⁰⁴

Due to the unique characteristics of the municipal securities market, the MSRB expects that in order for a security to qualify as sufficiently “similar” to the subject security, such security will have to be at least highly similar to the subject security with respect to nearly all of the listed “similar” security factors that are relevant to the subject security at issue.¹⁰⁵ The MSRB believes that recognizing this practical aspect of the municipal securities market supports a more rational comparison of a municipal security to only those that are likely to produce

¹⁰¹ Id.

¹⁰² Id.

¹⁰³ Id.

¹⁰⁴ Id.

¹⁰⁵ Id.

relevant and probative pricing information in determining the prevailing market price of the subject security.¹⁰⁶

f. Economic Models

If it is not possible to obtain information concerning the prevailing market price of the subject security by applying any of the factors discussed above, the proposed guidance permits a dealer to consider as a factor in assessing the prevailing market price of a security the prices or yields derived from economic models.¹⁰⁷ Under the proposed guidance, such economic models may take into account measures such as reported trade prices, credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, face value, and may consider all applicable pricing terms and conventions used.¹⁰⁸ Further, the proposed guidance, as clarified in the MSRB Response, requires that when a dealer utilizes a third-party pricing model it must have a reasonable basis for believing that the third-party pricing service's pricing methodologies produce evaluated prices that reflect actual prevailing market prices.¹⁰⁹ In the MSRB Response, the MSRB cautions dealers that they have the ultimate responsibility to determine the market value of a security and ensure the fairness and reasonableness of a price and any related mark-up or mark-down, and suggests that a dealer, in conducting its due diligence on a pricing service, may wish to consider the inputs, methods, models, and assumptions used by the pricing service to determine its evaluated prices, and how these criteria are affected as market conditions change.¹¹⁰ The MSRB contrasts its treatment of a

¹⁰⁶ Id.

¹⁰⁷ Id.

¹⁰⁸ Id.

¹⁰⁹ See MSRB Response, supra note 6, at 9.

¹¹⁰ Id. at 8-9.

dealer's use of an economic model provided by a third-party with the standard for a dealer's use of an economic model that the dealer uses or has developed internally. If a dealer relies on pricing information from an economic model the dealer uses or developed internally, the dealer must be able to provide information that was used on the day of the transaction to develop the pricing information (i.e., the data that were input and the data that the model generated and the dealer used to arrive at the prevailing market price).¹¹¹

g. Isolated Transactions or Quotations

Under the proposed guidance, isolated transactions or isolated quotations would generally have little or no weight or relevance in establishing the prevailing market price of a municipal security.¹¹² The MSRB notes that due to the unique nature of the municipal securities market, isolated transactions and quotations may be more prevalent therein than in other fixed income markets, and explicitly recognizes that an off-market transaction may qualify as an “isolated transaction” under the proposed guidance.¹¹³ Furthermore, the proposed guidance also provides that in considering yields of “similar” securities, except in extraordinary circumstances, a dealer may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields in “similar” municipal securities taken as a whole.¹¹⁴

C. Description of Proposed Amendment No. 1

In response to commenters' suggestions and, in part, to harmonize the proposed rule change with the FINRA Proposal, the MSRB proposes in Amendment No. 1 to amend the proposed rule change. Specifically, the MSRB proposes to amend the proposed rule change to:

¹¹¹ Id. at 8.

¹¹² See Notice, supra note 3, at 62954.

¹¹³ Id.

¹¹⁴ Id.

(1) clarify the trigger requirements for the proposed mark-up disclosure obligation by inserting the term “offsetting” to proposed Rule G-15(a)(i)(F)(1)(b) and thereby make clear the conditions precedent for triggering the mark-up disclosure obligation;¹¹⁵ (2) replace the requirement for dealers to disclose a hyperlink to a specific existing page on EMMA – the “Security Details” page – with a more generic requirement to disclose, in a format specified by the MSRB, a reference and, if the confirmation is electronic, a hyperlink to a webpage on EMMA that contains publicly available trading data for the specific security that was traded;¹¹⁶ (3) limit a dealer’s obligation to disclose the time of trade execution to only retail customers, as opposed to retail and institutional customers (as proposed in the Notice);¹¹⁷ (4) revise proposed Supplementary Material .06(b)(ii)(B) under Rule G-30 to include reference to “an applicable index” and thereby include language to address an appropriate spread relied upon for tax-exempt municipal securities;¹¹⁸ and (5) extend the implementation date for the proposed rule change from no later than one year following Commission approval of the proposed rule change to no later than 18 months following the Commission’s approval thereof.¹¹⁹

D. Effective Date of the Proposed Rule Change

The MSRB represents that it will announce an effective date of the proposed rule change in a regulatory notice to be published no later than 90 days following Commission approval of the proposed rule change.¹²⁰ The MSRB initially proposed that the effective date would be no later than 12 months following Commission approval of the proposed rule change. In

¹¹⁵ See Amendment No. 1, supra note 7, at 4, 15.

¹¹⁶ Id. at 4-5, 14.

¹¹⁷ Id. at 5, 14.

¹¹⁸ Id. at 5, 20.

¹¹⁹ Id. at 5.

¹²⁰ See Notice, supra note 3, at 62947.

Amendment No. 1, the MSRB proposes to extend the effective date so that it would be 18 months following Commission approval of the proposed rule change.¹²¹

III. Summary of Comments, MSRB's Response and the Investor Advocate's Recommendation

The Commission received seven comment letters regarding the proposed rule change.¹²² Many of the commenters expressed support for the goals of the proposal.¹²³ Many commenters, however, expressed some concern about implementing the proposal and requested guidance or certain changes to the proposal to facilitate and reduce the costs of implementation.¹²⁴ Areas of concern included: (1) the scope of the proposal; (2) methodology and timing for determining the PMP; (3) acceptable ways to present mark-up/mark-down disclosure information on the customer confirmations; (4) areas of inconsistency with FINRA's mark-up disclosure proposal;¹²⁵ and (5) the effective date of the proposed rule change and the costs of implementation. Additionally, the Investor Advocate submitted to the public comment file its recommendation letter (the "Investor Advocate Letter"), in which the Investor Advocate recommended that the Commission approve the proposed rule change.¹²⁶ The comments

¹²¹ See Amendment No. 1, supra note 7, at 5.

¹²² See supra note 4 (for list of comment letters).

¹²³ See SIFMA Letter, at 2 (expressing support for the MSRB's objective to enhance price transparency for retail investors); Wells Fargo Letter, at 3 (supporting the MSRB's efforts to improve price transparency in municipal markets); Fidelity Letter, at 2 (noting Fidelity's appreciation of regulatory efforts to improve price transparency in the fixed income markets); BDA Letter, at 1 (accepting the value of increasing market and price transparency for investors); RW Smith Letter, at 1 (supporting the objective of enhancing price transparency for market participants).

¹²⁴ Two commenters suggested that the MSRB would be best served by implementing an alternative disclosure regime focused on providing information about prevailing market conditions through EMMA. See SIFMA Letter, at 2; Wells Fargo Letter, at 2.

¹²⁵ See FINRA Proposal, supra note 11.

¹²⁶ See Investor Advocate Letter, supra note 5.

received with respect to this proposal, as well as the MSRB's responses, are summarized below, followed by a summary of the Investor Advocate Letter.

A. Scope of the Proposal

Several commenters addressed the same-day offsetting trade aspect of the proposal's scope. Specifically, commenters raised concerns that the same-day nature of the proposal would require a member to look forward to transactions occurring after the execution of a retail customer trade to determine whether that trade requires mark-up/mark-down disclosure, and that this would impose costs on members and disrupt the confirmation process.¹²⁷ One commenter urged the MSRB to eliminate the "look-forward requirement" so dealers could determine the need for disclosure at the time of trade.¹²⁸ Another commenter advocated for eliminating not only the look-forward aspect of the proposal, but also the look-back aspect.¹²⁹ According to this commenter, mark-up/mark-down disclosure should be calculated by reference to PMP in "all instances" and provided for all retail customer transactions "regardless of their origins."¹³⁰

In response, the MSRB stated that, while dealers could incur costs to identify trades subject to disclosure, it believed that disclosure based on a same-day trigger would deliver important benefits associated with increased pricing transparency.¹³¹ The MSRB also noted that it provided guidance in the Notice intended to clarify the timing of the mark-up determination for

¹²⁷ See Thomson Reuters Letter, at 3; FIF Letter, at 4-6.

¹²⁸ See Thomson Reuters Letter, at 3. This commenter also noted that members choosing to provide mark-up/mark-down disclosure on all confirmations in order to ease implementation of the rule might hesitate to do so unless they could provide additional text on customer confirmations to put the mark-up/mark-down disclosure "in context."
Id.

¹²⁹ See FIF Letter, at 4-6.

¹³⁰ Id. at 4-6.

¹³¹ See MSRB Response, supra note 6, at 3.

dealers that voluntarily determine to provide mark-up disclosure more broadly than specifically required by the proposed rule change.¹³²

One commenter asked whether the confirmation disclosure requirement is triggered only when a customer trade has an offsetting principal trade or if a dealer must continue to disclose its mark-up/mark-down until the triggering trade has been exhausted, at which point the dealer may choose to continue to disclose or not.¹³³

In its response, the MSRB confirmed that there must be offsetting customer and principal trades in order to trigger the mark-up disclosure obligation.¹³⁴ The MSRB stated that it was submitting Amendment No. 1 to ensure rule text clarity on this point by adding the word “offsetting” to the trigger language.¹³⁵ By way of example, the MSRB explained that if a dealer purchased 100 bonds at 9:30 AM, and then satisfied three customer buy orders for 50 bonds each in the same security on the same day without purchasing any more of the bonds, the proposal would require mark-up disclosure on two of the three trades, since one of the trades would have been satisfied by selling out of the dealer’s inventory rather than through an offsetting principal transaction by the dealer.¹³⁶

One commenter questioned how the proposal would apply to certain small institutions that may fit within the MSRB’s definition of “non-institutional customer,” but trade via accounts that settle on a delivery versus payment/receive versus payment (DVP/RVP) basis and rely on confirmations generated through the Depository Trust and Clearing Corporation’s institutional

¹³² Id.

¹³³ See SIFMA Letter, at 1. SIFMA made the identical comment in response to the FINRA Proposal. See SIFMA Letter to FINRA Proposal (Sept. 9, 2016), at 8.

¹³⁴ See MSRB Response, supra note 6, at 3-4.

¹³⁵ Id. at 4; see also Amendment No. 1, supra note 7, at 4, 15.

¹³⁶ See MSRB Response, supra note 6, at 4.

delivery (DTCC ID) system.¹³⁷ Because it is possible for those institutions to receive confirms through the DTCC ID process, the commenter asked the MSRB to clarify whether its proposal requires modifications to the DTCC ID system, or, in the alternative, to exempt DVP/RVP accounts from the proposed rule change.¹³⁸

The MSRB responded that it believes that investors who do not meet the “institutional account” definition should gain the benefits and protections of the proposed disclosures.¹³⁹ Accordingly, the MSRB stated that it does not believe exempting certain classes of “non-institutional investors” from receiving the proposed disclosures is desirable or consistent with the intended goals of the proposed rule change.¹⁴⁰

B. Mark-up/Mark-down Disclosure

1. Determination of PMP and Calculation of Mark-up/Mark-down in Accordance with Rule G-30

Commenters expressed concern about the need to determine PMP in accordance with Rule G-30, believing that this requirement would be operationally burdensome.¹⁴¹ These commenters requested that the MSRB provide additional guidance on how dealers may determine PMP and calculate mark-ups/mark-downs to facilitate compliance with this rule.¹⁴² Specifically, two commenters believed that dealers would need to automate the determination of PMP, but that automation of certain factors in the proposed guidance would be impracticable.¹⁴³

¹³⁷ See Thomson Reuters Letter, at 2.

¹³⁸ Id.

¹³⁹ See MSRB Response, supra note 6, at 15.

¹⁴⁰ Id.

¹⁴¹ See, e.g., BDA Letter, at 2-3; SIFMA Letter, at 6-8.

¹⁴² See BDA Letter, at 2-3; SIFMA Letter, at 6-8.

¹⁴³ See BDA Letter, at 2-3; SIFMA Letter, at 6.

One commenter believed that it would be “simply not practicable” to automate the PMP guidance set forth in Rule G-30 in a manner that would allow dealers to calculate and disclose mark-ups/mark-downs on an automated basis.¹⁴⁴ In particular, these commenters emphasized that it would be difficult to automate factors in the waterfall that require a subjective analysis of facts and circumstances.¹⁴⁵

In addition, a commenter also requested clarification from the MSRB that dealers may adopt “a variety of other reasonable methodologies to automate the calculation of PMP for disclosure purposes, including but not limited to pulling prices from . . . third-party pricing vendors, the dealer’s trading book or inventory market-to-market and contemporaneous trades by the dealer in the given security, or some variation thereof.”¹⁴⁶ This commenter further requested that it be deemed reasonable that dealers may “calculate PMP solely on the contemporaneous cost of the offsetting transaction(s) without further automating the waterfall.”¹⁴⁷

The MSRB responded by initially noting that dealers are not required to automate the PMP determination to comply with the proposed rule change.¹⁴⁸ The MSRB acknowledged, however, that many dealers may need to enhance existing technology to determine PMP in a consistent and efficient manner.¹⁴⁹ To help these dealers determine PMP, the MSRB cited to explanations given in the proposed rule change as well as additional clarifications contained in the MSRB Response on such topics as the determination of similar securities and the use of

¹⁴⁴ See SIFMA Letter, at 6.

¹⁴⁵ See BDA Letter, at 2-3 (identifying the portion of Rule G-30 that directs dealers to consider “similar securities”).

¹⁴⁶ See SIFMA Letter, at 6-7.

¹⁴⁷ Id. at 7.

¹⁴⁸ See MSRB Response, supra note 6, at 7.

¹⁴⁹ Id.

economic models.¹⁵⁰ The MSRB also stated that it may be reasonable for a dealer that chooses largely to automate the process of determining prevailing market price to establish, in its policies and procedures, objective criteria reasonably designed to implement aspects of the PMP waterfall that are not prescribed and for which dealers would have discretion to exercise a degree of subjectivity if the determination were not automated.¹⁵¹

On the subject of economic models, the MSRB explained that if a dealer considers economic models as a factor in determining the PMP of a security (which it is permitted to do if the PMP cannot be obtained by applying any of the factors at the higher levels of the waterfall), the dealer, if using an internal economic model, must be able to provide the information that was used on the day of the transaction to develop the pricing information.¹⁵² If the dealer is using a third-party economic model, then the dealer would typically not have access to such information but the dealer still retains the ultimate responsibility to ensure the fairness and reasonableness of a price and any mark-up or mark-down under Rule G-30.¹⁵³ The MSRB also explained that, before using a third-party pricing service, a dealer should have a reasonable basis for believing that third-party's pricing service produces evaluated prices that reflect actual prevailing market prices. The MSRB cautioned that such basis would not exist if a periodic review revealed a substantial difference between evaluated prices generated by the third-party pricing service and the prices at which actual transactions in the relevant securities occurred.¹⁵⁴ The MSRB also

¹⁵⁰ Id. at 7-8.

¹⁵¹ Id. at 12-13.

¹⁵² Id. at 8.

¹⁵³ Id.

¹⁵⁴ Id. at 8-9.

provided a list of factors for dealers to consider in conducting its due diligence and selecting a price service.¹⁵⁵

On the subject of alternative methods of determining PMP, the MSRB reaffirmed that dealers must have reasonable policies and procedures in place to determine PMP, and that those policies and procedures must be designed to implement the prevailing market price guidance, not to create an alternative manner of determining PMP.¹⁵⁶ The MSRB also stated that such policies and procedures must be reasonably designed to implement all applicable components of the proposed guidance, such as provisions regarding functionally separate trading desks, inter-affiliate transactions, the calculation of imputed mark-ups and mark-downs, the determination of similar securities, and the use of economic models.¹⁵⁷

Additionally, one commenter sought acknowledgment that different dealers may reach different conclusions as to whether securities are similar and that dealers may adopt reasonable policies and procedures to make that determination.¹⁵⁸ Another commenter sought clarification on the use of “isolated” transactions under the proposed guidance, noting that rule text in the proposed rule change provided that a dealer may give isolated transactions little consideration in establishing PMP, but the language in the proposal suggested a more restrictive approach.¹⁵⁹ Several commenters also requested that the MSRB revise the proposed guidance to more accurately describe the concept of spread in the municipal market.¹⁶⁰ The proposed guidance (as provided in the Notice) includes as one of its non-exclusive list of relevant factors to determine

¹⁵⁵ Id. at 9.

¹⁵⁶ Id. at 12.

¹⁵⁷ Id.

¹⁵⁸ See SIFMA Letter, at 9.

¹⁵⁹ See BDA Letter, at 3-4.

¹⁶⁰ See SIFMA Letter, at 10; BDA Letter, at 4; RW Smith Letter, at 2.

the degree to which a municipal security is similar, the factor of “the extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the ‘similar’ municipal security trades is comparable to the spread at which the subject security trades.” Commenters noted that only taxable municipal bonds trade at a spread to Treasuries.¹⁶¹

On the subject of similar securities, the MSRB confirmed that different dealers may reasonably reach different conclusions as to whether securities are similar, and that dealers may adopt reasonable policies and procedures to consistently implement the guidance.¹⁶² On the “isolated” transactions issue, the MSRB noted that the descriptive language included in the filing paraphrased the rule text and the actual rule text controls.¹⁶³ The MSRB clarified that a dealer may give little or no weight to pricing information resulting from an isolated transaction; the weight, if any, given to such a transaction is dependent on the facts and circumstances surrounding the transaction.¹⁶⁴ With respect to the proposed guidance’s suggestion that a similar security analysis consider the spread over U.S. Treasury securities, the MSRB agreed to amend the proposed guidance to include language relevant to the appropriate spread relied upon for non-taxable municipal bonds.¹⁶⁵ The MSRB also agreed to amend the proposed guidance language to clarify that a dealer may also consider the extent to which a spread over the “applicable index” at which the similar municipal security trades is comparable.¹⁶⁶

¹⁶¹ See SIFMA Letter, at 10; BDA Letter, at 4; RW Smith Letter, at 2.

¹⁶² See MSRB Response, supra note 6, at 13.

¹⁶³ Id. at 15.

¹⁶⁴ Id.

¹⁶⁵ Id. at 7; see also Amendment No. 1, supra note 7, at 5.

¹⁶⁶ See MSRB Response, supra note 6, at 7; see also Amendment No. 1, supra note 7, at 5.

2. Fair Pricing and Time of Determination of Prevailing Market Price

Commenters stated that the proposed guidance in the proposed rule change should apply solely for the purposes of calculating the mark-up or mark-down to be disclosed, and not “as an overarching fair pricing methodology under Rule G-30.”¹⁶⁷ In particular, one commenter stated its belief that the proposed guidance “originated as a necessary technical clarification solely as part of the retail disclosure requirement,” and was not general guidance applicable to all trades.¹⁶⁸ In the alternative, such commenter requested that if the MSRB planned to apply the proposed guidance for fair pricing purposes, it should only apply for retail customers, because such a limitation would be consistent with the terms of the proposed mark-up disclosure requirement and be more closely aligned with the prevailing market price guidance provided by FINRA in the supplementary material to FINRA Rule 2121.¹⁶⁹

In addition, one commenter addressed the issue of timing of the PMP determination, requesting that the MSRB proposal allow determination of the PMP at the time of trade for all processes, including those that capture confirm-related data in real-time, even if the actual issuance of the confirm is not until the end of the day.¹⁷⁰

The MSRB responded to the fair pricing issue by stating that a dealer that uses reasonable diligence to determine the PMP of a municipal security in accordance with the proposed guidance, and then discloses a mark-up based on such determination, should generally be able to rely on that determination for fair pricing purposes.¹⁷¹ The MSRB explained that it would be

¹⁶⁷ See SIFMA Letter, at 4; see also RW Smith Letter, at 2.

¹⁶⁸ See SIFMA Letter, at 4.

¹⁶⁹ Id. at 5.

¹⁷⁰ See Thomson Reuters Letter, at 2.

¹⁷¹ See MSRB Response, supra note 6, at 10.

confusing for investors to learn that the mark-up or mark-down disclosed on customer confirmations is not necessarily the mark-up or mark-down examined by regulators for fair pricing analysis.¹⁷² The MSRB also rejected commenter request to limit use of the proposed guidance for fair pricing purposes to retail customers.¹⁷³ The MSRB explained that such request was inappropriate because while certain institutional customers, like sophisticated municipal market professionals, could opt out of certain fair pricing protections for agency transactions, such opt-out was not possible for principal transactions.¹⁷⁴ Because the determination of PMP is critical to fair pricing determinations in principal transactions, the MSRB stated that it was not appropriate to limit the proposed guidance to transactions with retail customers only.¹⁷⁵

Responding to commenter concern, the MSRB confirmed that a dealer may determine the PMP for disclosure purposes based on information the dealer has at the time the dealer inputs the information into its systems to generate the mark-up disclosure, even when the actual issuance of the confirmation is not until the end of the day, as long as the dealer consistently applies its relevant policies and procedures in the same manner for all retail customers.¹⁷⁶ The MSRB also provided an example providing guidance on both timing and fair pricing issues.¹⁷⁷

C. Presentation of Mark-up/Mark-down Information on Customer Confirmations

The MSRB proposes to require that mark-ups/mark-downs be disclosed on confirmations as a total dollar amount (i.e., the dollar difference between the customer's price and the security's PMP, and as a percentage amount, (i.e., the mark-up's percentage of the security's

¹⁷² Id.

¹⁷³ Id. at 11.

¹⁷⁴ Id.

¹⁷⁵ Id.

¹⁷⁶ Id. at 10 & n.16.

¹⁷⁷ Id. at 10-11.

PMP). Several commenters noted that the new disclosures required by the proposal might cause investor confusion, as different members may determine the PMP for the same security differently, resulting in a lack of comparability or consistency across customer confirmations.¹⁷⁸

Commenters suggested different approaches to resolve potential investor confusion. Several commenters, for instance, argued that dealers should be permitted to label or qualify the mark-up/mark-down disclosed on the confirmation as “estimated” or “approximate.”¹⁷⁹ Other commenters suggested that dealers be allowed to add a description of the dealer’s process for calculating mark-ups and mark-downs.¹⁸⁰ Others suggested that dealers be permitted to describe the meaning of the mark-up/mark-down,¹⁸¹ or to indicate that it may not reflect profit to the dealer¹⁸² or the exact compensation to the dealer.¹⁸³ Two commenters suggested that to ensure consistent disclosure, any explanatory text that dealers may include on customer confirmations should be drafted and prepared by the MSRB.¹⁸⁴

The MSRB responded by stating that dealers should not be permitted to label the required mark-up/mark-down disclosure as “estimated” or “approximate”, because such labels have the potential to unduly suggest an unreliability of the disclosures or otherwise diminish their

¹⁷⁸ See BDA Letter, at 3; Wells Fargo Letter, at 4; SIFMA Letter, at 8; Fidelity Letter, at 3.

¹⁷⁹ See Fidelity Letter, at 3; SIFMA Letter, at 8.

¹⁸⁰ See BDA Letter, at 3; Fidelity Letter, at 3; SIFMA Letter, at 8.

¹⁸¹ See Fidelity Letter, at 3.

¹⁸² See Wells Fargo Letter, at 4. See also Thomson Reuters Letter, at 3 (noting that dealers may not want to provide mark-up/mark-down disclosure on all confirms without the ability to include text indicating that the mark-up/mark-down may not reflect the profit to the firm).

¹⁸³ See Fidelity Letter, at 3.

¹⁸⁴ See Fidelity Letter, at 3; BDA Letter, at 3.

value.¹⁸⁵ However, the MSRB agreed that a dealer should be permitted to include explanatory language or disclosures on confirmations to provide context and understanding for investors receiving mark-up and mark-down disclosures, such as an explanation of how the disclosure was derived.¹⁸⁶ In response to commenters' requests for the MSRB to provide standardized or sample disclosures that would be appropriate under the proposal, the MSRB stated that dealers should have the flexibility to determine how to craft such language for their customers, as long as such explanatory language is accurate and not misleading.¹⁸⁷

D. Time of Execution, Hyperlink to EMMA, and Harmonization with the FINRA Proposal

The MSRB's proposed rule change, as provided in the Notice, requires dealers to include on all trade confirmations a time-of-trade disclosure and on all trade confirmations a CUSIP-specific hyperlink to EMMA's "security details" page for that relevant municipal security. Notably, these disclosure requirements exist irrespective of whether the dealer has an obligation to disclose its mark-up or mark-down on a particular transaction. As originally proposed, the FINRA rule change did not contain a similar disclosure requirement. Several commenters, citing a desire for greater harmonization between FINRA and the MSRB, suggested that the MSRB remove or delay implementation of the time-of-trade and CUSIP-specific hyperlink requirements.¹⁸⁸ Other commenters suggested changes to the requirement, including replacing the CUSIP-specific hyperlink with a more general hyperlink to EMMA, which they argued would: reduce confusion by minimizing the risk of typographical errors made by investors who

¹⁸⁵ See MSRB Response, supra note 6, at 11.

¹⁸⁶ Id.

¹⁸⁷ Id. at 11-12.

¹⁸⁸ See Fidelity Letter, at 4-5; FIF Letter, at 1-2; Thomson Reuters Letter, at 3; Wells Fargo Letter, at 2; FIF Letter, at 8.

receive paper confirmations and have to manually type of the hyperlink in a web browser, avoid issues that arise if the web addresses to security-specific pages change, reduce the amount of space needed on the confirmation to fulfill the disclosure requirement, and generally ease the programming and operational burden of compliance.¹⁸⁹

One commenter also sought guidance on how dealers should implement the time-of-execution disclosure in adviser block-trade executions that are later allocated to that adviser's customers.¹⁹⁰ That same commenter also recommended that dealers should be permitted to combine the security-specific hyperlink disclosure with the official statement delivery obligation for primary issues under MSRB Rule G-32 in order to avoid potentially lengthy and duplicative disclosures.¹⁹¹

In response, the MSRB modified the proposed rule change in Amendment No. 1 to harmonize the MSRB's and FINRA's hyperlink and time of execution standards in all relevant, substantive, and technical respects.¹⁹² The harmonized proposals would require the disclosure of the time of trade or time of execution on retail customer confirmations, regardless of whether the dealer would be required to disclose the mark-up or mark-down on the customer transaction.¹⁹³ The proposals would also require a reference and hyperlink to a webpage on FINRA's Trade Reporting Compliance Engine ("TRACE") or EMMA, as applicable, containing trading data for

¹⁸⁹ See SIFMA Letter, at 13; Thomson Reuters Letter, at 3; BDA Letter, at 4; FIF Letter, at 8.

¹⁹⁰ See Fidelity Letter, at 5.

¹⁹¹ Id. at 5-6.

¹⁹² See MSRB Response, supra note 6, at 4-5; see also Amendment No. 1, supra note 7, at 4-5.

¹⁹³ See MSRB Response, supra note 6, at 5.

the specific security that was traded, along with a brief description of the type of information available on that page.¹⁹⁴

Further, to promote harmonization and enhance the user experience, the MSRB agreed to make a technical amendment to its proposed hyperlink requirement, replacing the requirement for a specific webpage hyperlink with a more generic requirement to hyperlink to a webpage on EMMA, in a format specified by the MSRB, containing publicly available trading data for the traded security.¹⁹⁵ The MSRB explained that this change in language is meant to more closely harmonize with the language in FINRA's proposal, and that, by using more general language to describe the hyperlink requirement, the MSRB and FINRA retain some flexibility to consider ways to make the landing page for investors accessing EMMA and TRACE via the hyperlink on confirmations more accessible and user friendly.¹⁹⁶ The MSRB also agreed, in the interest of harmonization and to provide some implementation relief, to amend the proposed rule change to require dealers to disclose time of execution for only retail customer confirmations, explaining that institutional customers are already likely to know the time of execution of their transaction.¹⁹⁷

In response to comments about investor confusion and potential error caused by the difficulty in typing in a lengthy hyperlink, the MSRB developed a more succinct EMMA URL for direct access to a security-specific page on EMMA. The MSRB stated its belief that this succinct URL, which can be used for the proposed disclosure, is easier to use and would decrease the number of characters an investor may need to type or input to access to relevant page on

¹⁹⁴ Id.

¹⁹⁵ Id.; see also Amendment No. 1, supra note 7, at 4-5.

¹⁹⁶ See MSRB Response, supra note 6, at 5.

¹⁹⁷ Id. at 5-6.

EMMA.¹⁹⁸ Addressing commenter concerns that such a hyperlink may expire, the MSRB also stated that it does not anticipate any future changes to the protocol for the succinct URL, and therefore it believes that hyperlinks that use the succinct URL will continue to function indefinitely.¹⁹⁹ The MSRB also confirmed that the disclosure of a security-specific hyperlink to EMMA would satisfy a dealer's official statement delivery obligation for primary issues under Rule G-32, as long as the hyperlink and URL are accompanied by the information required under Rule G-32(a)(iii).²⁰⁰

E. Anticipated Costs of Implementing the Proposed Rule Change by the Proposed Effective Date

Most commenters stated that the proposed rule change was too complex and costly to implement by the proposed effective date – one year from Commission approval of the proposed rule change. Commenters particularly emphasized the significant systems and programming modifications that they believed dealers and their third-party vendors would need to undertake in order to implement the proposal.²⁰¹ They also asserted that it would be particularly challenging to implement such changes in light of other regulatory initiatives slated to become effective in the near future.²⁰² As a result, commenters suggested implementation periods of at least two

¹⁹⁸ Id. at 6.

¹⁹⁹ Id.

²⁰⁰ Id. at 6-7.

²⁰¹ See, e.g., FIF Letter, at 1-2; Fidelity Letter, at 6-7.

²⁰² See BDA Letter, at 4-5; SIFMA Letter, at 11-12; Fidelity Letter, at 6-7; Thomson Reuters Letter, at 3-4; FIF Letter, at 2-4. Commenters identified the following initiatives: (1) the U.S. Department of Labor's conflict of interest rule, see 81 FR 20946 (Apr. 8, 2016); (2) the Consolidated Audit Trail, see Securities Exchange Act Release No. 77724 (Apr. 27, 2016), 81 FR 30614 (May 17, 2016); (3) the Financial Crimes Enforcement Network's Customer Due Diligence Requirements for Financial Institutions, see 81 FR 29398 (May 11, 2016); and (4) additional other MSRB, FINRA, and Commission rule changes.

years and often longer.²⁰³ In response, the MSRB agreed to extend the implementation time to provide that the effective date of the proposed rule change will be no later than eighteen months following Commission approval.²⁰⁴

Numerous commenters also expressed concern about the total cost of the proposed rule change.²⁰⁵ Two commenters questioned whether the costs of implementing the rule may outweigh the benefits, and one questioned whether FINRA and the MSRB had conducted a cost-benefit analysis.²⁰⁶ Several commenters also expressed the belief that the heaviest costs and burdens would fall on smaller dealers and may lead to dealers to reduce head count or exit the industry.²⁰⁷ Commenters suggested alternative proposals that they viewed as achieving similar goals in a less costly manner, including focusing more on developing EMMA to achieve greater transparency.²⁰⁸ One commenter also noted its belief that there was no evidence the MSRB considered or measured the risk that its proposal would impair liquidity in the municipal security market, or that the proposal would cause some principal-holding dealers to shift towards a riskless principal model.²⁰⁹

²⁰³ See Wells Fargo Letter, at 4 (requesting an implementation period of three years but no less than two); Fidelity Letter, at 6 (two years); BDA Letter, at 4 (two years); Thomson Reuters Letter, at 4 (two years); SIFMA Letter, at 11 (three years); and FIF Letter, at 2 (requesting an implementation date “well into 2018”).

²⁰⁴ See MSRB Response, *supra* note 6, at 13.

²⁰⁵ See, e.g., RW Smith Letter, at 2; SIFMA Letter, at 2-3.

²⁰⁶ See FIF Letter, at 4; SIFMA Letter, at 3.

²⁰⁷ See FIF Letter, at 4; BDA Letter, at 4-5. See also RW Smith Letter, at 2 (noting that “reputable small firms close their doors and people lose their jobs, and not because they didn’t serve their clients well, but instead because decision makers did not stop long enough to consider the unequal and unfair burden being placed on small firms through rule-making”).

²⁰⁸ See RW Smith Letter, at 2; SIFMA Letter, at 2; Wells Fargo Letter, at 2.

²⁰⁹ See SIFMA Letter, at 3-4.

The MSRB acknowledged that the proposed rule change would impose burdens and costs on dealers.²¹⁰ The MSRB also noted that, in response to earlier comments it had received, it had already acknowledged and recognized the costs in its filing supporting the proposed rule change.²¹¹ These costs included those that would be incurred by dealers to develop a methodology to satisfy the disclosure requirement, identify the trades subject to the disclosure requirement, and convey the required mark-up and disclosure information to the customer.²¹² The MSRB also acknowledged that it had received some cost estimates from one commenter.²¹³

However, while recognizing these costs, the MSRB reiterated its belief that the proposed rule change reflects the lowest overall cost approach to achieving a worthy regulatory objective. It noted that retail investors are currently limited in their ability to compare transaction costs associated with transactions in municipal securities.²¹⁴ It also noted that mark-up and mark-down disclosure may improve investor confidence, allow customers to better evaluate the services provided by dealers, promote pricing transparency, improve communication between dealers and customers, and make the enforcement of Rule G-30 more efficient.²¹⁵ Finally, the MSRB noted that it had engaged in a multi-year rulemaking process on this proposal, had evaluated numerous reasonable regulatory alternatives, and had implemented several changes to make the rule less costly and burdensome.²¹⁶

²¹⁰ See MSRB Response, supra note 6, at 14.

²¹¹ Id.

²¹² Id.

²¹³ Id.

²¹⁴ Id.

²¹⁵ Id.

²¹⁶ Id.

F. Recommendation of the Investor Advocate

As noted above, the Investor Advocate submitted to the public comment file its recommendation to the Commission that the Commission approve the proposed rule change.²¹⁷ In its recommendation, the Investor Advocate stated its belief that the proposed rule change’s “enhancements to pricing disclosure in the fixed income markets are long overdue and will greatly benefit retail investors.”²¹⁸ Specifically, the Investor Advocate noted that the required mark-up disclosures will better equip retail investors “to evaluate transactions and the quality of service provided to them by a firm,” help regulators and retail investors detect improper dealer practices, and make it less likely that dealers will charge excessive mark-ups.²¹⁹ Ultimately, the Investor Advocate focused its attention on “four key issues” – consistency of approach between the MSRB and FINRA; same-day disclosure window; the use of prevailing market price as the basis for calculating mark-ups; and the need for dealers to look through transactions with affiliates – as the focus of its review, and stated “each of these issues has been resolved to our satisfaction” in the proposed rule change.²²⁰

With respect to the MSRB and FINRA adopting consistent rules related to confirmation disclosure, the Investor Advocate highlighted that the proposed rule change and the FINRA Proposal “provide a coordinated and consistent approach to mark-up disclosure in corporate and municipal bond transactions.”²²¹ Accordingly, the Investor Advocate concluded that “this

²¹⁷ See Investor Advocate Letter, supra note 5.

²¹⁸ Id. at 2.

²¹⁹ Id.

²²⁰ Id. at 6.

²²¹ Id.

deliberative approach will lead to consistent disclosures across the fixed income markets and will provide retail investors with better post-trade price transparency.”²²²

Addressing the same-day disclosure window, the Investor Advocate noted its agreement “that the window of time for disclosure should be the full trading day.”²²³ According to the Investor Advocate, a shorter time-frame – e.g., the two-hour window previously proposed by the MSRB – could inappropriately incentivize dealers to alter their trading practices to avoid the obligation to disclose mark-ups.²²⁴

Discussing the proposed rule change’s use of prevailing market price as the basis for mark-up disclosure, the Investor Advocate stated its belief that the prevailing market price-based disclosure has advantages over the initially proposed reference price-based disclosure.²²⁵ Specifically, the Investor Advocate noted that though the “PMP-based disclosure may lead to disclosure of a smaller cost to retail investors under certain circumstances . . . the PMP-based approach provides retail investors with the relevant information about the actual compensation the retail investor is paying the dealer for the transaction . . . [and] . . . [i]t reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.”²²⁶ Moreover, the Investor Advocate noted that the prevailing market price-based disclosure regime could more easily be expanded beyond the presently contemplated same-day disclosure window.²²⁷ As a result, the Investor Advocate stated its support for the MSRB’s use

²²²

Id.

²²³

Id. at 7.

²²⁴

Id.

²²⁵

Id.

²²⁶

Id. at 7-8.

²²⁷

Id. at 8.

of the prevailing market price-based disclosure regime.²²⁸ Finally, the Investor Advocate stated its support for the proposed rule change’s requirement that dealers express the mark-up both as a total dollar amount and as a percentage of the prevailing market price.²²⁹

With respect to dealer transactions with affiliates, the Investor Advocate highlighted its concern with dealer-affiliate trading arrangements, and concluded that the proposed rule change “satisfies [the Investor Advocate’s] concerns by making clear that a dealer must look through non-arms-length transactions with affiliates to calculate PMP.”²³⁰

Finally, with respect to the implementation of the proposed rule change, the Investor Advocate stated its support for a one-year implementation period, noting that such period would be reasonable despite the technical and system changes that might be required for compliance with the proposed rule change.²³¹

IV. Discussion and Commission Findings

After carefully considering the proposed rule change, the comments received, the MSRB Response Letter, and Amendment No. 1, the Commission finds that the proposed rule change, as modified by Amendment No.1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB. In particular, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 15B(b)(2)(C) of the Act,²³² which requires, among other things, that the MSRB’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade,

²²⁸ Id. at 8-9.

²²⁹ Id. at 9.

²³⁰ Id. at 9-10.

²³¹ Id. at 10-11.

²³² 15 U.S.C. 78o-4(b)(2)(C).

to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest, and not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

A. Mark-up/Mark-down Disclosure

The Commission notes that the goal of improving transaction cost transparency in fixed-income markets for retail investors has long been pursued by the Commission.²³³ In particular,

²³³ See Securities & Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) (“2012 Report”), available at: <https://www.sec.gov/news/studies/2012/munireport073112.pdf> (recommending that the MSRB consider possible rule changes that would require dealers acting as riskless principal to disclose on the customer confirmation the amount of any mark-up or mark-down and that the Commission consider whether a comparable change should be made to Rule 10b-10 with respect to confirmation disclosure of mark-ups and mark-downs in riskless principal transactions for corporate bonds); Chair Mary Jo White, Securities and Exchange Commission, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors (June 20, 2014), available at: <https://www.sec.gov/News/Speech/Detail/Speech/1370542122012> (Chair White noting that to help investors better understand the cost of their fixed income transactions, staff will work with FINRA and the MSRB in their efforts to develop rules regarding disclosure of mark-ups in certain principal transactions for both corporate and municipal bonds); Statement on Edward D. Jones Enforcement Action (August 13, 2015), available at: <https://www.sec.gov/news/statement/statement-on-edward-jones-enforcement-action.html> (Commissioners Luis A. Aguilar, Daniel M. Gallagher, Kara M. Stein, and Michael S. Piwowar stating, “We encourage the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) to complete rules mandating transparency of mark-ups and mark-downs, even in riskless principal trades.”). See also Investor Advocate Letter, supra note 5, at 2 (supporting the proposed rule change and stating that enhancements to pricing disclosure in the fixed-income markets are “long overdue and will greatly benefit retail investors”); Recommendation of the Investor Advisory Committee to Enhance Information for Bond Market Investors (June 7, 2016), available at: <https://www.sec.gov/spotlight/investor-advisory-committee->

in the 2012 Report, the Commission stated that the MSRB should consider possible rule changes that would require dealers acting as riskless principal to disclose on customer confirmations the amount of any mark-up/mark-down.²³⁴ The Commission believes that the establishment of a requirement that dealers disclose mark-ups/mark-downs to retail investors, as proposed, will advance the goal of providing retail investors with meaningful and useful information about the pricing of their municipal securities transactions.²³⁵

The Commission believes the proposed rule change, as modified by Amendment No. 1, is reasonably designed to ensure that mark-ups/mark-downs are disclosed to retail investors, at least when a dealer has effected a same-day off-setting transaction, while limiting the impact of operational challenges for dealers. For example, with respect to dealers that generate intra-day trade confirmations, the Commission notes that the MSRB stated that dealers need not delay the confirmation process.²³⁶ The Commission further notes that the MSRB stated that dealers would not be expected to cancel and resend a confirmation to revise the mark-up or mark-down disclosure solely based on the occurrence of a subsequent transaction or event that would otherwise be relevant to the calculation of the mark-up or mark-down under the proposed guidance.²³⁷

2012/recommendation-enhance-information-bond-market-investors-060716.pdf (recommending that the Commission work with FINRA and the MSRB to finalize mark-up/mark-down disclosure proposals).

²³⁴ See 2012 Report, supra note 233, at 148.

²³⁵ While MSRB Rule G-15 generally requires a dealer to disclose to customers on the transaction confirmation the amount of any remuneration to be received from the customer, if the dealer is acting as agent, there is no comparable requirement if the dealer is acting as principal. See MSRB Rule G-15(a)(i)(A)(1)(e).

²³⁶ See Notice, supra note 3, at 62955.

²³⁷ Id.

Under the proposed rule change, disclosed mark-ups/mark-downs are to be calculated in compliance with the proposed guidance, and expressed as a total dollar amount and as a percentage of the PMP of the subject security.²³⁸ The Commission believes that this information will, for example, promote transparency of dealers' pricing practices and encourage dialogue between dealers and retail investors about the costs associated with their transactions, thereby better enabling retail investors to evaluate their transaction costs and potentially promoting price competition among dealers.

As discussed above, concerns were raised that the proposed rule change's requirement to determine PMP in compliance with the proposed guidance would make it difficult for dealers to automate PMP determinations at the time of the trade.²³⁹ The Commission believes that the MSRB has adequately responded to these concerns, and that the price and mark-up/mark-down disclosed to the customer on a confirmation must reflect the actual PMP the dealer used to price and mark-up/mark-down the transaction at the time of the trade. The Commission believes that it is feasible to automate the determination of PMP in accordance with the proposed guidance to the extent a dealer chooses to do so, and agrees with the MSRB. The Commission further believes that a dealer's election to use automated processes to support pricing of retail trades, and thus determine the PMP, would not justify departure from the proposed requirement that dealers price municipal securities in accordance with the proposed guidance.

When the Commission approved the prevailing market price guidance contained in FINRA Rule 2121.02²⁴⁰ (which is substantially similar to and generally harmonized with the

²³⁸ Id. at 62950.

²³⁹ See notes 141-147, and accompanying text, supra.

²⁴⁰ See Securities Exchange Act Release No. 55638 (Apr. 16, 2007), 72 FR 20150, 20154 (Apr. 23, 2007) (SR-NASD-2003-141) (the "2007 PMP Order"). When the Commission

proposed guidance being approved by the Commission in this Order²⁴¹), the Commission stated that such guidance is consistent with long-standing Commission and judicial precedent regarding fair mark-ups, and that it:

provides a framework that specifically establishes contemporaneous cost as the presumptive prevailing market price, but also identifies certain dynamic factors that are relevant to whether contemporaneous cost or alternative values provide the most appropriate measure of prevailing market price. The Commission believes that the factors that govern when a dealer may depart from contemporaneous cost and that set forth alternative measures the dealer may use are reasonably designed to provide greater certainty to dealers and investors while providing an appropriate level of flexibility for dealers to consider alternative market factors when pricing debt securities.²⁴²

The Commission believes this reasoning remains sound and is not persuaded that the proposed requirement to disclose mark-ups/mark-downs on customer confirmations necessitates an approach contrary to the proposed guidance.

Further, in response to commenters that requested confirmation or clarification that firms may adopt reasonable policies and procedures regarding the implementation of particular aspects of the guidance, the MSRB stated its expectation that dealers will have reasonable policies and procedures in place to determine PMP, and that such policies and procedures are consistently applied across customers.²⁴³ The MSRB further explained that it expects those policies and procedures to be designed to implement the proposed guidance, not to create an alternative

approved this prevailing market price guidance, such guidance was found in the supplementary material to the then-existing NASD Rule 2440.

²⁴¹ For description of the proposed guidance, see notes 80-119, and accompanying text, supra.

²⁴² See 2007 PMP Order, supra note 240.

²⁴³ See MSRB Response, supra note 6, at 12.

manner of determining PMP.²⁴⁴ More specifically, the MSRB stated its expectation that such policies and procedures will be reasonably designed to implement all applicable components of the PMP determination.²⁴⁵ The MSRB also proposed to extend the implementation date of the proposal, as modified by Amendment No. 1, from one year to 18 months following Commission approval,²⁴⁶ and represented that it will continue to engage with FINRA with the goal of promoting generally harmonized interpretations of the proposed guidance and the FINRA guidance, as applicable and to the extent appropriate in light of the differences between the markets.²⁴⁷ The Commission believes that the MSRB's responses appropriately address commenters' concerns regarding implementation of the proposed rule change.

Also, as discussed above, commenters had questions regarding the presentation of mark-up/mark-down information on customer confirmations, and, in particular, sought the MSRB's concurrence that it would be acceptable to label the required mark-up/mark-down disclosure as an "estimate" or an "approximate" figure.²⁴⁸ The Commission agrees with the MSRB,²⁴⁹ and does not believe that it would be consistent with the Act or the proposed rule change for dealers to label the required mark-up/mark-down disclosure as an "estimate" or an "approximate" figure, or to otherwise suggest that the dealer is not disclosing the actual amount of the mark-up/mark-down it determined to charge the customer. However, the proposed rule change is appropriately flexible to permit a dealer to include language on confirmations that explains PMP as a concept, or that details the dealer's methodology for determining PMP, or that notes the availability of

²⁴⁴ Id.

²⁴⁵ Id.

²⁴⁶ Id. at 13.

²⁴⁷ See Notice, supra note 3, at 62952.

²⁴⁸ See note 179, and accompanying text, supra.

²⁴⁹ See MSRB Response, supra note 6, at 11.

information about methodology upon request, provided such statements are accurate. The Commission emphasizes that dealers will be required to disclose the actual amount of the mark-up/mark-down that they have determined to charge the customer, in accordance with the proposed amendments to Rules G-15 and G-30 being approved in this Order.

B. Requirement to Provide EMMA Reference/Hyperlink and Time of Execution on All Retail Customer Confirmations

The Commission also believes that the MSRB's proposal to require dealers to disclose, in a format specified by the MSRB, a reference and, if the confirmation is electronic, a hyperlink to webpage on EMMA that contains publicly available trading data for the specific security that was traded is reasonably designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to protect investors, is in the public interest, and does not impose any burden on competition not necessary or appropriate in furtherance of the Act, and is therefore consistent with the Act.

In the Commission's view, providing a retail investor with a security-specific reference or hyperlink on the trade confirmation and the time of trade execution will facilitate retail customers obtaining a comprehensive view of the market for their securities, including the market as of the time of trade. The Commission believes that these items will complement the MSRB's existing order-handling obligations (e.g., best execution) by providing retail investors with meaningful and useful information with which they will be able to independently evaluate the quality of execution obtained from a dealer.

Some commenters urged the MSRB to require a general hyperlink to EMMA, rather than a security-specific hyperlink.²⁵⁰ According to the MSRB, a security-specific hyperlink would provide retail investors, who typically have less ready access to market and pricing information

²⁵⁰ See notes 189, and accompanying text, supra.

than institutional customers, with a more comprehensive picture of the market for a security on a given day, and would increase investors' awareness of, and ability to access, this information.²⁵¹ Further, in Amendment No.1, the MSRB made a technical amendment to its proposed hyperlink disclosure requirement that mitigates concerns raised by commenters. The MSRB asserted that the use of such language, which, based on coordination between the MSRB and FINRA, is similar to the language used by FINRA in its related proposal, is responsive to commenter requests for more harmonization and would reduce the potential for confusion.²⁵² The Commission has carefully considered Amendment No. 1 in light of comments received urging the MSRB and FINRA to harmonize both the substance and timing of their proposals. The Commission concurs with the MSRB that the time of execution along with a security-specific reference or hyperlink on a customer confirmation would provide customers with the ability to obtain a comprehensive view of the market for their security at the time of trade.

C. Prevailing Market Price Guidance

In 2007, the Commission approved detailed interpretive guidance that establishes a framework for how a dealer should determine the PMP for non-municipal debt securities in a variety of scenarios.²⁵³ In the 2012 Report, the Commission recommended that the MSRB should consider possible rule changes that would set forth more detailed guidance as to how dealers should establish the PMP for municipal securities, and that is consistent with that provided by FINRA for non-municipal debt securities.²⁵⁴

²⁵¹ See Notice, supra note 3, at 62949, 62956.

²⁵² See MSRB Response, supra note 6, at 5.

²⁵³ See 2007 PMP Order, supra note 240.

²⁵⁴ See 2012 Report, supra note 233, at 148.

The proposed guidance is designed to provide a clear and consistent framework to dealers for determining PMP to aid in compliance with their fair-pricing obligations under Rule G-30 and their mark-up/mark-down disclosure obligations under Rule G-15. The proposed guidance provides a framework that specifically establishes contemporaneous cost as the presumptive PMP, but also identifies certain factors that are relevant to whether contemporaneous cost or alternative values provide the most appropriate measure of PMP. The Commission believes that the factors that govern when a dealer may depart from contemporaneous cost and that set forth alternative measures the dealer may use are reasonably designed to provide greater certainty to dealers and investors while providing an appropriate level of flexibility for dealers to consider alternative market factors when pricing municipal securities. As noted in the 2012 Report, providing dealers a clear and consistent framework as to how they should approach the complex task of establishing the PMP of municipal securities should enhance their ability to comply with fair pricing obligations, facilitate regulators' ability to enforce those obligations, and better protect customers.²⁵⁵

In addition, by recognizing the facts-and-circumstances nature of the analysis and by setting forth a logical series of factors to be used when a dealer departs from contemporaneous cost, the MSRB has proposed an approach for determining the PMP of a municipal security that is reasonable and practical in addressing the interests of dealers and investors and is consistent with the Act and longstanding Commission and judicial precedent relating to determining PMP and mark-ups. The Commission also notes that the MSRB represented that the proposed guidance is substantially similar to and generally harmonized with the FINRA guidance for non-

²⁵⁵

Id.

municipal fixed income securities that is set forth in FINRA Rule 2121.02.²⁵⁶ While several commenters raised concerns with respect to implementing the proposed guidance,²⁵⁷ the Commission believes that the MSRB has reasonably addressed the comments.

D. Efficiency, Competition, and Capital Formation

In approving the proposed rule change, as modified by Amendment No. 1, the Commission has considered its impact on efficiency, competition, and capital formation.²⁵⁸ The Commission believes that the proposed rule change, as modified by Amendment No. 1, could affect efficiency, competition, and capital formation in several ways.

The Commission believes that the proposed rule change could have an impact on competition among dealers. For instance, costs associated with the proposed rule change could raise barriers to entry in the retail trading market. The MSRB acknowledges that the proposed rule change may disproportionately impact less active dealers that, as indicated by data, currently charge relatively higher mark-ups than more active dealers; however, overall, the MSRB believes that the burdens on competition will be limited and the proposed rule change will not impose any additional burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act.²⁵⁹ The MSRB recognizes that the proposed rule change could lead dealers to consolidate with other dealers, or to exit the market, however, the MSRB does not believe—and is not aware of any data that suggest—that the number of dealers exiting the market or consolidating would materially impact competition.²⁶⁰ Additionally, the

²⁵⁶ See Notice, supra note 3, at 62952.

²⁵⁷ See notes 141-147, and accompanying text, supra.

²⁵⁸ 15 U.S.C. 78c(f).

²⁵⁹ See Notice, supra note 3, at 62956-57.

²⁶⁰ Id.

Commission believes that the proposed rule change provides dealers with the flexibility to develop cost-effective policies and procedures for complying with the proposed rule change that reflect their business needs and are consistent with the regulatory objectives of the proposed rule change.

By increasing disclosure requirements for retail customer confirmations, the proposed rule change could improve efficiency—in particular, price efficiency—and the improvement in pricing efficiency could promote capital formation. The Commission believes that mark-up/mark-down disclosure and the inclusion of a reference/hyperlink to security-specific transaction information on EMMA on retail customer confirmations will promote price competition among dealers and improve trade execution quality. An increase in price competition among dealers would lower transaction costs on retail customer trades. To the extent that the proposed rule change lowers transaction costs on retail customer trades, the proposed rule change could improve the pricing efficiency and price discovery process. The quality of the price discovery process has implications for efficiency and capital formation, as prices that accurately convey information about fundamental value could better facilitate capital allocations across municipalities and capital projects. Furthermore, to the extent that the proposed rule change would lower transaction costs on retail customer trades, the proposed rule change could lower bond financing costs for municipalities and capital projects. Lower transaction costs could attract more investors to the municipal securities market, which could increase the demand for municipal securities. Higher demand could lead to higher municipal security prices and higher municipal security prices could contribute to increased funding opportunities for municipalities and capital projects.

As noted above, the Commission received seven comment letters on the filing. The Commission believes that the MSRB considered carefully and responded adequately to the concerns raised by commenters. For all the foregoing reasons, including those discussed in the MSRB Response, the Commission believes the proposed rule change, as modified by Amendment No. 1, is reasonably designed to help the MSRB fulfill its mandate in Section 15B(b)(2)(C) of the Act which requires, among other things, that MSRB's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest, and not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.²⁶¹

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

²⁶¹ 15 U.S.C. 78o-4(b)(2)(C).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2016-12 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2016-12. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the principal office of MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2016-12 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the date of publication of notice of the filing of Amendment No. 1 in the Federal Register. Amendment No. 1 amends the proposed rule change to (1) replace the requirement that dealers supply a hyperlink to the “Security Details” page on EMMA of specific security that was traded with a requirement to provide, in a format specified by the MSRB, a reference, and if the confirmation is electronic, a hyperlink to a webpage on EMMA that contains publicly available trading data for the specific security that was traded; (2) limit the time of execution disclosure requirement to retail investors; (3) add the term “offsetting” to proposed Rule G-15(a)(i)(F)(1)(b) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement; (4) add the phrase “an applicable index” to proposed Supplementary Material .06(b)(ii)(B) of Rule G-30 to ensure that the proposed guidance contemplates an appropriate spread relied upon for tax-exempt municipal securities; and (5) extend the implementation period of the proposed rule change from no later than one year to no later than 18 months.

According to the MSRB, it has proposed the revisions included in Amendment No. 1 in response to specific commenter suggestions and commenters’ general preference for the MSRB and FINRA to adopt harmonized mark-up disclosure rules and prevailing market price guidance. The Commission notes that the addition of the terms “off-setting” and “an applicable index” to the proposed rule change is solely a clarification amendment for the avoidance of doubt and that the amendment does not alter the substance of the rule. Furthermore, extension of the implementation period of the proposal from no later than one year to no later than 18 months is appropriate and responsive to the operational and implementation concerns raised by commenters. The Commission also notes that after consideration of the comments the MSRB

received on its proposal to require a security-specific hyperlink to EMMA and the execution time of the transaction, the MSRB amended its proposal in a manner that is identical to the Amendment No. 1 that FINRA has filed.²⁶² Based on the foregoing, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 15B(b)(2)(C) of the Act, which requires, among other things, that the MSRB's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest, and not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.²⁶³

The Commission notes that it today has approved the FINRA Proposal, as modified by FINRA Amendment No. 1, and believes that in the interests of promoting efficiency in the implementation of both proposals, it is appropriate to approve the proposed rule change, as modified by Amendment No. 1, concurrently. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,²⁶⁴ to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

²⁶² See FINRA Amendment No. 1, supra note 11.

²⁶³ 15 U.S.C. 78o-4(b)(2)(C).

²⁶⁴ 15 U.S.C. 78s(b)(2).

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁶⁵ that the proposed rule change (SR-MSRB-2016-12), as modified by Amendment No. 1, is approved on an accelerated basis.

For the Commission, pursuant to delegated authority.²⁶⁶

Brent J. Fields
Secretary

²⁶⁵ 15 U.S.C. 78s(b)(2).

²⁶⁶ 17 CFR 200.30-3(a)(12).

